

1.0 Executive Summary

1.1 Scope of Services

Pursuant to the terms of our agreement letter dated July 2, 2003, KPMG LLP (“KPMG”) was engaged by Holland & Hart LLP (“Holland & Hart”) to conduct an analysis of the Idaho Water Center (“IWC”) and Idaho Place (“IP”) capital construction projects, collectively referred to as the “Project” hereinafter, undertaken by the University of Idaho (“UI”) and the University of Idaho Foundation (“UIF”). This work was performed on behalf of the Idaho State Board of Education (“ISBE”), and included the following scope of services:

- a) Perform a general review of the UI’s and UIF’s management of the Project.
- b) Determine the UI’s use of, and transactions involving, agency accounts for loans to UIF.
- c) Identify the source of the funds loaned from UI to UIF through the agency account.
- d) Understand the development costs incurred by UI and UIF for the Project, including amounts advanced, the purpose for which they were advanced, and whether the management and use of funds for these costs was appropriate.
- e) Review and make recommendations to the ISBE for changes, if any, to UI’s internal management controls with respect to financial transactions by and between UI and UIF.
- f) Review and make recommendations to the ISBE for changes, if any, to UI’s internal financial and management controls with respect to development projects.
- g) Review and make recommendations to the ISBE for changes, if any, to the ISBE policies concerning the relationship of state universities and their foundations.
- h) Review and report to the State Board on the audit reports and the audit process for UI and UIF and the adequacy of the disclosures made by the auditors to the ISBE concerning financial transactions related to the Project.
- i) Review and make recommendations to the ISBE for changes, if any, to the internal and external audit policies and procedures of UI and the ISBE.

1.2 Summary of Findings

Based on the information we reviewed, it appears the Project was not adequately planned, executed, monitored, or reported. Our review uncovered what we believe are significant control and process weaknesses, exposing the UI and the UIF to unnecessary risks and costs for a project of this magnitude. Due to the nature and significance of our findings, we believe a complete re-engineering of the processes, policies, procedures and controls associated with capital projects is required.

Our findings and observations are summarized as follows:

- a) The apparent lack of an adequate funding strategy or plan resulted in the UIF executing numerous loans and promissory notes to fund Project expenditures. As a result, the UIF has approximately \$25m of outstanding obligations related to this Project. Non-Project related assets controlled by the UIF collateralize these obligations.
- b) The actual costs incurred, or committed to by the UIF prior to turnover to the Idaho State Building Authority (“ISBA”) total approximately \$32.8m. Of this amount, we confirmed payments to vendors and contractors totaling approximately \$27.5m. We did not verify the remaining \$5.3m of payments including interest expenses, commitments for land not yet purchased, payments not adequately supported, and invoices or costs less than \$10,000.
- c) UI Agency Account SCZ307 incurred approximately \$8.1m in cost associated with the Project, of which approximately \$1m has been reimbursed by the ISBA. The use of Agency Account SCZ307 represented a deviation from standard UI procedures, and appeared to be an inappropriate mechanism to fund the Project, or any other expense of this magnitude.
- d) No facts were disclosed as part of our procedures that would raise any accounting issues with respect to the accounting reported by UI and UIF for the year ended June 30, 2001, for the Project that were not identified in previous reports.
- e) Critical up-front strategy decisions such as how to deliver the Project and how to compensate vendors did not appear appropriately considered, analyzed or documented.
- f) Project roles and responsibilities related to organization, planning, delivery, and monitoring of UI capital projects are inadequately defined and not documented. This led to confusion regarding accountability, responsibility, and support of the Project. For example, we found no single point of overall fiscal accountability for cost tracking, budgeting, and reporting. We observed instances where key Project functions were assigned or assumed by individuals who appeared to lack the requisite skills and experience.
- g) Policies, procedures, and controls surrounding UI capital project, finance and accounting functions appear to be inadequately defined and not documented. When they existed, informal policies and procedures were not adhered to, or were reportedly overridden by management on this Project.
- h) We observed insufficient and poorly coordinated project reporting and cost management including weaknesses in cost reporting, cash flow reporting and controls, budget development, and project approval and tracking mechanisms.

- i) We found no overall procurement plan for the Project. Solicitation activities appeared poorly planned and executed, resulting in sub-optimal or non-existent vendor agreements. We could not find formally executed agreements for 4 of the 6 vendors with the largest expenditures on the Project. The largest vendor, Civic Partners, executed its work under a formally executed memorandum of understanding, which in our opinion does not constitute an adequate agreement for the services rendered.
- j) We found no formal practices concerning change and risk management on the Project.
- k) It appears Civic Partners was reimbursed approximately \$6.5m in questionable costs, which were approved by the UI and the UIF.
- l) The UI Internal Audit department appears inadequately organized and administered. Based on the information we reviewed, it does not appear the Internal Audit function plays any role in reviewing or investigating capital construction practices at the UI.
- m) The existing policies and procedures with respect to recognition of Institutional Foundations appear generally reasonable and acceptable in relation to their established purpose. However, the role and authority of the UIF within the agreement is not adequately defined. The agreement also lacks adequate controls and definition in the areas of organizational structure, conflicts of interest, designation of responsibilities, separation of duties, threshold authorities, and management reporting.

Our recommendations are included in Section 8 of this report.

1.3 Exclusions and Limitations

Our review was based on information retained by the UI and UIF and made available to us through “Caseshare”, the electronic document management system used by Holland & Hart. In addition, we relied on interviews conducted by KPMG (see Appendix 1), review of interviews performed and interview memorandums prepared by Holland & Hart, and other information collected or made available during the course of our work. In addition to other factors presented in this report, the limited documentation practices and poorly organized information made available by the UI and UIF for our review made our work more difficult than we expected for a project of this size, scope and complexity.

Targeting key-word searches were performed to locate and review relevant Project information on Caseshare. Due to budget and schedule limitations, a complete and exhaustive review was not performed on all documents in Caseshare.

As part of our work, we asked that certain Project information (See Appendix 2) be obtained directly from Civic Partners for our review. To our knowledge, this information was requested on our behalf by Holland & Hart, but was never received from Civic Partners. As a result, this information was not included as part of our work.

We understand the computer hard drives for Jerry Wallace's computers were erased or reformatted. In addition, we understand the electronic mail files for Joanne Reece were reportedly unintentionally erased from her computer. As a result, this information was not included as part of our work.

Collectively, these factors may affect the accuracy of the information, conclusions and recommendations presented herein. This report is based on the information we reviewed, and is subject to change should additional information come to our attention.